NOTE: 1. This is an open book examination.

2. ANSWER ALL QUESTIONS.

THIS EXAMINATION CONSISTS OF 2 QUESTIONS
EACH QUESTION IS WORTH 50 MARKS
(ALLOCATION OF MARKS WITHIN EACH QUESTION INDICATED IN SQUARE BRACKETS AFTER THE QUESTION)
QUESTION 1

Sylvie Langevin is an industrial designer who graduated from Concordia University with a Master of Industrial Design degree in May 2011. After travelling around the world for the rest of the year, Sylvie obtained a position with the aerospace division of Boombardier Inc. ("Boombardier"), working on the next generation of its popular Conqueror series of executive jets. Boombardier is a Canadian company with publicly-traded shares listed on the Toronto Stock Exchange (TSX).

Although Boombardier’s aerospace division is located in the town of Mirabel, Québec, approximately 50 kilometres north of Montréal, Sylvie’s contract with Boombardier provided that she was required to be on site at the Mirabel facility only one day each week and was otherwise expected to work from home. It also stipulated that she would report weekly to her supervisor at Mirabel who would assign her specific responsibilities to be completed during the week, that she was required to work no less than 35 hours per week, that she would be paid a "salaire de base" (base salary) of $75,000 and a "salaire supplémentaire" (a bonus) of $100 per hour for any hours worked beyond the minimum, that she could purchase up to 10,000 shares from Boombardier each year commencing one year after she started working for the company for an amount equal to the closing price of the shares on the TSX on the date she started working for the company, and that Boombardier would provide an interest-free loan to enable her to purchase these shares should she choose to do so. The contract also stated that Sylvie understood that she would be an independent contractor who was responsible for paying her own taxes and pension plan contributions.

While studying at Concordia University, Sylvie lived in a one-bedroom apartment near the Atwater Market in downtown Montréal, which she gave up when she graduated and travelled the world. After securing the position with Boombardier, Sylvie was able to rent a larger apartment in the same building, which had a second bedroom that she could use as an office. The size of this apartment was 1,000 square feet, of which the second bedroom accounted for 200 square feet. The distance from this apartment to Boombardier’s aerospace division in Mirabel is 56 kilometres, taking the shortest normal route on the Autoroute Decarie and the Autoroute Laurentides.

Sylvie started working for Boombardier on January 2, 2012, when the closing price of the company’s shares on the TSX was $3 per share. Over the course of the year, she became recognized as a valuable addition to the design team, suggesting innovative design solutions for its Conqueror jets that promised to significantly reduce production costs as well as ongoing operating costs and carbon emissions. In December 2012, Boombardier offered Sylvie a permanent position with the company as special assistant to the company’s Vice-President of Business Aircraft, Etienne Brulé, at a salary of $120,000 per year. Sylvie accepted the offer and commenced her new duties on January 1, 2013.
LAW 407, Section 1

Question 1 (continued)

The next day, January 2, 2013, Sylvie exercised her option to acquire 10,000 shares for $3 per share, borrowing $30,000 from the company in the form of an interest-free loan repayable at the earliest of three years or when she left the company. At the time that she purchased the shares, their trading price on the TSX was $5 per share.

Unlike her work with the Conqueror design team, Sylvie’s new position as special assistant to the Vice-President of Business Aircraft required that she be present at Boombardier’s Mirabel facility on a full-time basis. After commuting from Montréal for three weeks in January 2013, she decided to move closer Mirabel, and purchased a small house in the town of Saint-Jérôme, 14 kilometres from the Mirabel facility. The house cost $150,000 and Sylvie paid $2,000 to movers to transport her belongings from her Montréal apartment to the house in Saint-Jérôme, $500 to her former landlord to cancel the lease on the Montréal apartment, and $300 to a notary for legal services relating to the purchase of the house.

Sylvie worked diligently as special assistant to Etienne Brulé, and was often called upon to travel with him on business trips to promote Conqueror jets to potential clients in Moscow, Shanghai and Dubai. On one of these trips, Etienne had too much to drink at a dinner meeting with a client and made unwanted advances toward Sylvie as they returned to their hotel rooms. Although Sylvie attempted to laugh off the incident and put it behind her, Etienne persisted after they returned to Mirabel. After several unsatisfactory meetings with the company’s human resources department, Sylvie decided to quit her job at Boombardier and look for a new job in Montréal. Before doing so, however, she contacted an employment lawyer who advised her to sue Boombardier for sexual harassment and constructive dismissal.

On June 30, 2013, Sylvie notified Boombardier that she was leaving the company immediately, and would be seeking damages for sexual harassment and constructive dismissal. The next day she contacted a real estate agent to list her Saint-Jérôme house for sale, and began contacting potential employers for a new job. Although Sylvie was able to find a job at Zodiac Aerospace Limited (“Zodiac”), which manufactures equipment for regional and business aircraft, the job did not start until January 1, 2014, and her salary at Zodiac was $20,000 less than her salary at Boombardier. After selling the Saint-Jérôme house for $125,000, Sylvie moved back to Montréal, where she was able to rent an apartment in her old building near the Atwater Market. In order to sell the house, Sylvie paid a commission of $2,500 to the real estate agent. She also paid $2,000 to movers to transport her belongings back to Montréal. While the distance from the Saint-Jérôme house to the Zodiac office is 60 kilometres, the distance from her apartment to the Zodiac office is 15 kilometres.
LAW 407, Section 2

Question 1 (continued)

Upon hearing from Sylvie’s lawyer, Boombardier was keen to settle the case in order to avoid adverse publicity. After some negotiation, the company offered and Sylvie accepted $80,000 for lost income, $25,000 as compensation for the loss in the sale of the Saint-Jérôme house, and $50,000 as compensation for sexual harassment. It also forgave the $30,000 loan that she had received in order to purchase Boombardier shares.

In computing her income for her 2012 taxation year, Sylvie included her “salaire de base” (base salary) of $75,000 as well as additional payments for hours worked beyond the minimum, against which she deducted 20% of the rent on her apartment and automobile expenses incurred in driving from Montréal to Mirabel one day per week (a percentage of gasoline expenses, maintenance costs and lease payments based on the ratio of kilometres driven to and from Mirabel to total kilometres driven in the year). In computing her income for her 2013 taxation year, Sylvie included $60,000 in salary that she received from Boombardier up to June 30, against which she deducted the legal fees to purchase the house in Saint-Jérôme, the real estate commission on the sale of this house, the $500 payment to her landlord to cancel the lease on her Montréal apartment, and payments to movers to transport her belongings from Montréal to Saint-Jérôme and back to Montréal.

After a recent audit of Sylvie’s tax returns for her 2012 and 2013 taxation years, you have been asked to advise the Canada Revenue Agency (CRA) on her income for each year. In particular, the CRA would like your opinion on the following questions:

(1) was Sylvie an employee of Boombardier or an independent contractor in 2012? [8 marks];

(2) could Sylvie deduct 20% of the rent on her apartment in computing her income for her 2012 taxation year? [6 marks]

(3) could Sylvie deduct automobile expenses in computing her income for her 2012 taxation year? [5 marks]

(4) what, if any, amount should Sylvie have included in respect of the Boombardier shares that she acquired on January 2, 2013? [5 marks]

(5) what, if any, other amounts should Sylvie have included in computing her income for her 2013 taxation year? [12 marks] and

(6) what, if any, amounts could Sylvie deduct in respect of the move from Montréal to Saint-Jérôme and back to Montréal? [14 marks]

In your answers, please refer to relevant statutory provisions and judicial decisions.

END OF QUESTION 1
QUESTION 2

John Chesterton lives in West Vancouver, where he carries on a business as a real estate agent, earning commissions on the sale of high-end residential properties. In 2011 John received the Vancouver Real Estate Board’s Professional Excellence Award at a gala dinner held at the Westin Bayshore Hotel, where he was presented with a cheque for $5,000. In computing his income for his 2011 taxation year, John did not include any amount in respect of this award.

In addition to his business as a real estate agent, John also owns several residential apartment buildings in Vancouver’s West End, from which he derives rental income. In the fall of 2011, the owner of a run-down building on Comox Street (the “Building”) that had been converted into a rooming house decided to list the property for sale for $2.2 million. Although the value of this property (the “Comox Street Property”) had been assessed at $2 million for municipal tax purposes in 2010, virtually all of this value was attributable to the land and none to the building. Thinking that the site would be ideal for another residential apartment building, John decided to purchase the property, tear down the Building and construct a new building in its place.

After conferring with his tax advisor, John offered $2,250,000 for the property, on the condition that $2 million of this purchase price would be allocated to the Building and $250,000 to the land. The vendor accepted the offer without paying any attention to the allocation of the purchase price, and John acquired the Comox Street Property on November 1, 2011. In order to pay for the property, John borrowed $1.8 million by mortgaging the Comox Street Property, and the remaining $450,000 by mortgaging his personal residence in West Vancouver.

Although an initial draft of the contract of purchase and sale stipulated that the Comox Street Property would be delivered to John in a vacant state, John’s tax advisors suggested that he should waive this condition in favour of a requirement that all tenants must vacate the Building no later than April 30, 2012. In computing his income from the Comox Street Property for his 2011 taxation year, John included rental income from these tenants of $10,000 for the months of November and December, against which he deducted interest expenses for these months of $12,000 on the borrowed funds that he used to purchase the property, property taxes of $2,000 for these months, and capital cost allowance of $100,000 on the building (a class 6 building of frame construction) based on a capital cost of $2 million (taking into account the half year rule in subsection 1100(2) of the Income Tax Regulations), resulting in a net loss of $104,000, which he deducted against net rental income from other residential apartment buildings in the West End.

The day that John obtained possession of the Comox Street Property, he submitted an application to the City of Vancouver to demolish the Building and construct an eight-story
Question 2 (continued)

apartment building on the same site. Since the Building had been the subject of several complaints over the years, the City was keen to fast track its demolition, and approval was granted on March 15, 2012. Six weeks later, the last tenant vacated the Building and demolition commenced on May 1, 2012. The demolition took two weeks to complete and cost a total of $50,000.

Although the City was quick to approve demolition of the Building, the same was not true of John’s proposed redevelopment of the site. Neighbours complained that an eight-story building would block sunlight and that increased density would increase traffic congestion. By August 31, 2012, the City had yet to approve the proposed development, and had floated the idea that John should reduce the height of the building to six stories and provide for more underground parking. Frustrated with the delay and the prospect of additional conditions on the development, John decided to sell the Comox Street Property, leaving it to a subsequent purchaser to negotiate with the City. The next day, John listed the property for sale for $3 million.

Knowing that there were several obstacles to development of the Comox Street Property, potential purchasers were reluctant to pay $3 million for the property. In early October, however, a well-known developer of condominiums in Vancouver offered to pay $2.5 million. Although John rejected this offer, he make a counter-offer proposing that the purchaser could pay $2,250,000 on Closing, $250,000 a year later and $250,000 a year after that, without any payment of interest. The purchaser agreed, and the sale closed on November 1, 2012. The final contract also included provisions providing for a pre-payment discount and a late payment penalty computed at an annual rate of 5%.

In computing his income for his 2012 taxation year, John reported a taxable capital gain of $1.25 million from the disposition of the Comox Street Property. In computing his income from the Comox Street Property for his 2012 taxation year, John included rental income of $20,000 for the months of January to April during, against which he deducted interest expenses of $60,000 from January to the end of October on the borrowed funds that he used to purchase the property, property taxes of $10,000 for these ten months, demolition costs of $50,000, and a terminal loss of $1.9 million, resulting in a net loss of $2 million, which he deducted against the taxable capital gain and income from all other sources.

On the sale of the Comox Street Property, proceeds were paid first to discharge the outstanding principal on the mortgage, which was $1,750,000. With the remaining $500,000, John purchased a condo in Whistler, where he enjoys skiing in the winter and golfing in the summer. After taking possession in December 2012, John spent two weeks in the condo, skiing at Blackcomb-Whistler and enjoying the holiday season in Whistler. For the rest of the ski season, however, John found that he was too busy working in Vancouver
LAW 407, Section 1

Question 2 (continued)

to spend much time at the condo. As a result, he rented out the condo for $1,500 during the March school break and listed the condo for sale in April 2013 at a price of $500,000. After two months without any offers, John finally accepted an offer for $435,000 in June 2013, and used the proceeds to discharge the mortgage on his personal residence in West Vancouver. In computing his income for his 2013 taxation year, John did not include any amount in respect of the rental income for the condo during the March break, and deducted a business loss of $65,000 on the basis that he had acquired the condo as an adventure in the nature of trade.

John recently received a Notice of Reassessment for his 2011, 2012 and 2013 taxation years which:

(1) included the $5,000 award from the Vancouver Real Estate Board in his business income for his 2011 taxation year [5 marks];

(2) allocated $2 million of the purchase price of the Comox Street Property to the land and $250,000 to the building under section 68 of the Income Tax Act [6 marks];

(3) disallowed the deduction of capital cost allowance on the Building in 2011 and a terminal loss on the Building in 2012 on the grounds either that it was not acquired for the purpose of gaining or producing income as required by paragraph 1102(1)(c) of the Income Tax Regulations or that the general anti-avoidance rule in section 245 of the Income Tax Act should apply [12 marks];

(4) disallowed the deduction of interest expenses in computing John’s income from the Comox Street Property in 2011 and 2012 on the basis that the borrowed funds were not used for the purpose of earning income from a business or property as defined by subsection 9(1) of the Income Tax Act [8 marks]

(5) characterized the cost of demolishing the Building as a capital expense which should be added to the capital cost of the land [6 marks];

(6) characterized a portion of the proceed from John’s sale of the Comox Street Property as interest income rather than a capital receipt [5 marks]; and

(7) included the $1,500 rental income on the Whistler condo in computing John’s income for his 2013 taxation year and disallowed his deduction of a business loss on the sale of the condo on the basis that it was personal use property [8 marks].

Please advise John on the legal issues raised by this Notice of Reassessment, referring to relevant statutory provisions and judicial decisions.

END OF EXAMINATION